MR. McBRIDE: Thank you, Mr. Chairman, members of the Board. I want to join in the comments about former Chairman Morgan. We've sometimes disagreed, but you've never been disagreeable and you've always been first rate, and we'll miss you.

COMMISSIONER MORGAN: Thank you very kindly.

MR. McBRIDE: And I also want to thank you, Mr. Chairman, for giving us ample time here today, and for holding this hearing.

Mr. Chairman, EEI is the association, the investor-owned electric utility industry. Its members generate most of the electricity generated in the United States. Many are regulated, so we see both sides of the issues before you.

Over one-half of the nation's electricity is generated with coal. Coal is the single most important commodity to the railroads. So EEI's members depend on the railroads and they depend on EEI's members. This is the most symbiotic of relationships.

Now, the price of electricity is critical to the nation's well-being, and the delivered price of coal is often more than one-half of the entire cost of the electricity derived from the coal. And the cost of the transportation, as compared to the cost of the coal, is often more than one-half of the total delivered cost.

So the cost of coal transportation, which amounts to several billion dollars per year to EEI's members and other electricity generators, is a consumer issue and an economic issue of great importance to the country.

Now, EEI does not bring rate cases, but its members do, and several have cases pending before the Board or at issue in the Court of Appeals. Personally, I have no rate cases pending before the Board and have not for several years. A rate complaint I think we all feel, on the shippers side, is a failure of the commercial process, but it is so because when shippers are

captive they cannot compel a competitive rate so they must seek a regulated rate.

Now, Mr. Chairman, I'm mindful of your notice of not summarizing and repeating verbatim our comments, but rather commenting on other parties' testimony and comments. I want to set the stage for you about what the problem is here.

The problem is that most shippers cannot get through the door of this agency with a meaningful filing. Now, part of that is unarguable, that they're not captive. If they're competitive, they don't need to seek regulation. No one quarrels with that. So we're only talking about captive shippers.

Now, the small shipment shippers uniformly have never filed a small shipment complaint before this Board, as you noted in your opening comments. And I understand you may hold a hearing on that in the future, so I won't dwell on the details about why that is so here today, except to say that the Court of Appeals seems to hold you to your stand-alone cost standard, and the stand-alone cost standard is impossible for the small shipment shippers to meet, given the amounts that are at issue. So we have a total conundrum.

And if they ever win, they'd have to litigate in the Court of Appeals about whether they're a small shipment shipper, which would defeat the very purpose of bringing the case. So legislative relief I think is necessary, and I believe former Chairman Morgan has so indicated to Congress previously.

So now we're only talking about large shipment shippers. No no-coal shipper virtually ever brings a case before the Board, because they don't move coal, as Mr. Dowd has described, and the unit train is the most efficient form of transportation in most cases.

One exception was FMC Corporation, which moves soda ash in unit trains and which brought a case before the Board. But it got about as much out of the case as it cost to try the case, and it has said that it will not be back.

So because of the characteristics of non-coal shippers' movements, generally the rate process does not work for them, because they do not have the kind of repetitive, high-volume unit train movements that lend themselves to making a showing under the stand-alone cost standard.

So that leaves only the coal shippers, the only parties who can litigate under your guidelines in any effective manner. Now many of them have a problem in attempting to get relief because of the Board's bottleneck rulings.

And here we respectfully disagree with the Board's prior rulings, because the bottleneck decisions were not compelled by the statute, as the Eighth Circuit's decision said, and require the coal shipper to pay a monopoly rate over the entire route and not just over the bottleneck. So that further reduces the number of the shippers who have a valid complaint before the Board.

So we're only talking about a very few shippers who can ever bring a case here and win. You noted there were 10 pending, Mr. Chairman. At any other regulatory agency in this town that would be a vanishingly small number of complaints.

EEI's members, for example, have to defend their rates before the FERC. There are hundreds, if not thousands, of cases pending before FERC at any given time.

Now, the comments of the railroads, particularly Union Pacific, suggest that because of cost-cutting they can't afford to have people devoted to the task of producing data or participate in proceedings before this Board. And I'm sorry we've all had to engage in cost-cutting over the years. When I first started roaming the halls of the ICC, it had 2,000 employees. You're down to about 140.

Law firms have had to reduce their staffs. So have EEI and AAR. It's the way of the world. But the fact of the matter is that a franchise to operate a railroad, or a certificate of public convenience and necessity, is a privilege. It's a license

granted by the government, and it comes with a price. The regulatory compact, the quid pro quo, is that you must participate in the regulation of your business where Congress has deemed that to be necessary.

So I'm afraid they're going to have to produce the data, and they're going to have to make the people available to participate in the cases before you.

Now, lastly, there's yet another burden that appears to be on the horizon, and that is that although the 1985 coal rate guidelines the Western Coal Traffic League previously summarized required simply that the hypothetical stand-alone railroad carry all of its costs, the TPL Montana case now suggests that the Board will require each segment, so far undefined of the stand-alone railroad, to carry all of its costs.

That was never part of coal rate guidelines as we read it, and the principle appears to have no limitation. One could keep segmenting virtually to a vanishingly small size of the segment and subject the hypothetical railroad to that test. In our view, that decision is a threat to many coal rate cases being brought that otherwise are meritorious under the existing guidelines.

Now, background about the guidelines themselves. Some of us lived through that proceeding, and as Western Coal Traffic League just told you the guidelines are largely the product of the railroad's own advocacy. If I can put it to you squarely, the railroads won that case. They got what they asked the Board to adopt. They got stand-alone costs as the absolute maximum that any economist could justify for a maximum reasonable rate.

And our economists don't disagree that that is the economic principle. Dr. Kahn has said so before this Board, for example. They conceded that a lesser standard would be applicable if the railroad was achieving revenue adequacy, but no one argued -- and there is not a word in the coal rate guidelines decision that suggests that any rate could ever be higher than

the SAC standard, no matter what the revenue condition of the railroad.

So as I read the railroad's testimony, and I think Mr. Dowd has suggested this as well, the railroads are complaining that the Board's process actually works and that rates sometimes get reduced. But it's the process that they proposed and that they proposed to live by and that every economist said is the appropriate process to live by.

So we've got coal rate guidelines. I didn't understand that they were at issue in this proceeding. I understood this proceeding was about processing rate complaints, not about those standards themselves, but I read the railroad testimony as putting those guidelines at issue, which frankly I think is outside the scope of where we are in the proceeding to date, but I'm doing as you asked and responding to them. I don't think the public, though, has had notice that substantive standards are at issue.

Now, the shippers at first, under coal rate guidelines, didn't think they could make them work. They thought it was too daunting a task, but over time they did make them work. Market dominance was daunting, but as Chairman Morgan indicated the Board has been helpful in eliminating product and geographic competition in most cases, and that was an improvement. And the shippers learned to build a stand-alone railroad.

But the decision of the ICC about coal rate guidelines was based on a very critical predicate. And I want to read to you first what former Chairman Taylor said in that decision. This is at ICC 2nd 549, one sentence, concurring opinion.

"Because the allowance of appropriate discovery is the actual key to making these guidelines serve the 'balancing of interest' purpose they have been designed to achieve, I am both concerned and hopeful that the Commission will afford captive coal shippers adequate access to whatever relevant information they need in challenging the reasonableness of rail rates on

their traffic."

Now, AAR in its comments has cited the previous page and claims that the previous page, page 548, stands for the proposition that the shippers have to show some particularized need for their discovery. It says nothing of the sort.

What it says is we recognize that shippers may require substantial discovery to litigate a case under CMP -- constrained market pricing -- and we are prepared to make that discovery available to you. However, a shipper seeking discovery must state with particularity the nature and substance of the charges it seeks to prove as well as the basis for its belief in those charges.

And as Mr. Dowd already indicated, that means you have to have a well-pled complaint, and then the paragraph goes on to indicate that the shipper will get relevant discovery that is responsive to the charges in the complaint. And this is how the paragraph ended.

Given our announced intention to grant reasonably drawn discovery requests, we will expect potential litigants to negotiate in good faith voluntary discovery tailored to the case at hand and with adequate protection for sensitive data, thus minimizing the need for Commission intervention. Couldn't have said it any better.

I would propose to you that the way to solve this problem is to have the technical conference that AAR proposes after the evidence goes in, at the beginning, after the complaint is filed. We propose that FERC ALJs before whom we appear regularly, and before whom the Board sends us in a rail merger case to do discovery, preside over it. They could preside over the mediation if you wanted to do that at that time also, but negotiate the production of all this data.

As Mr. Dowd was indicating, we know what this data is. The Commission staff knows what data is needed -- the traffic tapes and the other data that one needs to put the case together.

The railroads know what has to be produced, just produce it. That's what we do at FERC.

Then, you could have the mediation either then if it makes sense, although we're skeptical that it does, or later at the time they propose the technical conference when all of the evidence is in, and that FERC ALJ or whoever mediates would understand what each side's case is, and then might understand what litigation risks each side is encountering.

At the outset of the case, all we know is this. The shipper says, "My rate is X, and it ought to be X minus Y." And the railroad says, "No. X is right." Now, what is a FERC ALJ supposed to do with that? Because he doesn't know what rate is going to come out of the stand-alone cost standard.

We were over at FERC to try to negotiate some of these things years ago in the competitive access proceeding -- Ex Parte 575. We got nothing accomplished.

The railroads didn't have an interest in changing those rules at that time. The railroads now are the ones trying to change the rules because the shippers are winning some of the cases. We can go over to FERC and talk about it. But when the complaint is filed, the commercial process is broken down and it's time to get on with producing the evidence, because as Vice Chairman Burkes has indicated the statute requires that it be done expeditiously.

And I understand you, Chairman Nober, want to do that as well. I commend you for it. Here are some of the ways I am proposing that you do it. Rather than litigate endlessly all these discovery requests, and chew up staff resources and Board resources, we know what data needs to be produced.

Now, the stand-alone railroad, of course, depends on data from the railroads, not from the shippers. So the shippers need far more data in these proceedings than the railroads do.

So to say, as the railroads did, "We're being even-handed here, we'll have the same discovery standards for both,"

sounds great, but it doesn't make any sense, because they're the architects of the stand-alone cost standard and the stand-alone railroad, and they have to produce the data in order for you to meet the tests that they design.

Now, we're not unsympathetic to the costs that are being regulated. We have the same problems, but I think the kinds of proposals that I just made would actually cut down substantially on those costs.

Mr. Chairman, these rules are working. That's why these cases are being filed, and I would suggest to you there's a lot of wisdom in the admonition "if it ain't broke, don't fix it" with respect to the discovery standard. If you change the discovery standard, even one inch, you will have 10 to 20 years of litigation about what that change meant with respect to the production of data.

If there are abuses going on, deal with the abuses on a case-by-case basis. Don't change the standard. You've got the standard just right in coal rate guidelines. The problem is that the data is actually proving people's cases.

Now, I also seem to understand that there is an argument about the Board's decision in the Wisconsin Power and Light case on appeal in the D.C. Circuit. As I understand it, the Board set the rate at the stand-alone level.

Now, if there are problems with the evidence, that's a problem in that particular case. But if the argument is we can't make enough money, if our rates are held to the stand-alone standard, I'm sorry, but that's the standard the railroads advocate, and they have to find another way to do it.

With all due respect, one cannot even say the railroads are not earning their cost of capital. They may not be meeting the Board's revenue adequacy standards, but as we've shown previously -- and as I think the Board has been willing to acknowledge -- there are serious problems with those standards, to the point that Dr. Kahn authored a report which we submitted

to the Board, which showed that the standards are fatally flawed and don't prove anything.

And Wall Street doesn't look at those standards. We asked Wall Street years ago, "What do you look at to determine whether the railroads are making enough money?" Two things -- return on equity and earnings growth. Tony Hatch is the author of that. He'd be happy to tell you what I just told you, which was said in the presence of hundreds of people, is true.

So I would suggest to you that's what we ought to look at -- return on equity as the standard, and by that standard no one ever seems to think they're making enough money. My clients, too. But the railroads might look a lot better under that standard.

So now with respect to any other details of the proposed rule, let me just quickly summarize, because I think our comments are very consistent with those of Western Coal Traffic League that compulsory mediation won't solve anything if the parties are not willing to participate in it, because it's voluntary and not obligatory. And so the courts only have mediation in certain cases where it's appropriate.

In fact, I had a case in the Court of Appeals last year with the Board in which I sought mediation, and the Board's response was, "It's not appropriate in all cases." Well, apart from that particular case, I agree, it's not appropriate in all cases. If the parties don't want to mediate, there's not much point of making them go through another hoop.

Your proposals for expediting resolutions of discovery disputes, if it comes to that, if the voluntary discovery that I have suggested and that the ICC said in 1985 was the approach that should be followed, are commendable. And having staff prompt disputes of those matters -- prompt resolution of those disputes so that we can keep the cases moving is exactly right. And any other way that we can participate in technical conferences with the staff and the railroads in the manner that

Western Coal suggested we agree with.

Now, just a few other comments about the railroads' testimony. On variable costs, let me add to the point, because I think it's terribly important, that Western Coal made. If the costs, according to movement-specific data, of a movement are $10, the statute says the rate that you can prescribe, no matter what the stand-alone cost evidence shows, is no less than $18 per ton, 180 percent of the variable cost.

But if we go to system average cost, contrary to decades of precedent of this Board and its predecessor, instead of movement-specific cost, and the average costs are $12, you can do the math and you'll find that the threshold magically becomes $21.60, 180 percent of $12. And the railroad just got a rate increase to $3.60.

So it's extremely important to stick to the movement-specific data, because of that jurisdictional threshold.

Now, by the way, the railroads also say they're reducing rates; they're not increasing them. Well, I beg to differ. First, you don't have the data. It's in confidential contracts. And second, it's well-known since these -- the merger costs that the railroads incurred that they've been increasing lots of charges, not just rates. The shipper pays transportation costs; he doesn't just pay a rate.

So, for example, Norfolk Southern quadrupled the daily demurrage charge in 2001 for coal shipments along the Ohio River and reduced the amount of free time at the same time, thereby increasing demurrage bills from a few hundred or a thousand dollars a month to hundreds of thousands of dollars per month.

Norfolk Southern recently announced it was going to try to take a fuel surcharge increase on contract rates that have a different mechanism for escalating those rates. So rate increases are occurring here and there. Where they're not it's because of competition, and there's nothing you can do about it.

To say that because you decided in one case, Wisconsin

Power and Light, that that rate exceeded stand-alone costs, that that somehow causes the railroads to have to reduce rates for anybody else, is a non sequitur. There's no reason why they have to do that.

The only reason they have to reduce rates is if they're above the stand-alone standard, and only if you order them to. Otherwise, it's competition that's driving whatever rate reductions there may be out there. And when you respond, by the way, in negotiations with the railroads by saying, "Well, this is what the stand-alone rate would be," they say, "We don't set rates that way. We set rates in the market."

Now, on the highly confidential issue, I want to just point out that the railroad's argument is the exact opposite of the argument they make in the merger cases. In the merger cases, they've argued vociferously that in-house counsel should not get highly confidential information.

That's been litigated repeatedly in the merger cases when the shippers or others come in and ask for such data, and the Board has said, and I think properly, you've got to be very careful before you ever allow that, because in-house counsel are subject to different pressures than outside counsel and consultants.

So, and note the proposal here is only that the highly confidential data go to in-house counsel in rate cases, not in merger cases where it might be helpful to the shippers. And I think the proposal, too, to have to refile vast amounts of what's been already filed under seal in redacted form is just a further unnecessary cost. And then they would have your staff adjudicate disputes about whether enough has been redacted or too much. It's all way too burdensome in an already burdensome process.

As I've said, technical conferences are a great idea all the way along. And with that, I think I'll conclude by saying that we support the proposal to expedite. We're skeptical about mediation, but it might work at a later point in the case.

And we applaud you very much for trying to move these things along, but we urge you in the strongest terms not to change the discovery standard. You got it right in 1985. It has worked for 18 years. If it ain't broke, don't fix it.

Thank you very much.